December 15, 2010

International Accounting Standards Board 30 Cannon Street, London EC4M 6XH United Kingdom

Dear Sir/Madam,

International Accounting Standards Board Exposure Draft ED/2010/9 *Leases*

The Body of Experts and Licensed Accountants of Romania (CECCAR) is pleased to comment on the International Accounting Standards Board Exposure Draft ED/2010/9 *Leases*. We have considered the ED, as well as the accompanying draft application guidance and the Basis for Conclusions and reached to the conclusions below.

The accounting model

The exposure draft proposes a new accounting model for leases in which:

- (a) a lessee would recognise an asset (the right-of-use asset) representing its right to use an underlying asset during the lease term, and a liability to make lease payments (paragraphs 10 and BC5–BC12). The lessee would amortise the right-of-use asset over the expected lease term or the useful life of the underlying asset if shorter. The lessee would incur interest expense on the liability to make lease payments.
- (b) a lessor would apply either a performance obligation approach or a derecognition approach to account for the assets and liabilities arising from a lease depending on whether the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected term of the lease (paragraphs 28, 29 and BC23–BC27).

Question 1: Lessees

- (a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?
- (b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

We acknowledge the conceptual merits of the right-of-use model as long it is applied consistently within the standard. If the assets recognised are the rights of use and the assets are a bundle of rights than the "tangible-intangible" distinction is not a relevant criteria in deciding the accounting treatment. Also, other projects of IASB develop a view based on control in the detriment of one based on "risks and rewards". This ED maintains the reference to the "risks and rewards" approach. The project underlies the debate on the role of the balance sheet (to reflect the financial position of the entity or its exposure to risks).

We agree that the lessee should recognise amortisation of the right-of-use and interest on the lease liability.

Question 2: Lessors

- (a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
- (b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?

Depending on the extent to which a lessor retains exposure to risks or benefits associated with the underlying asset, a lessor would apply either a performance obligation approach or a derecognition approach.

We consider that the performance obligation approach is not consistent with the view that assets are a bundle of rights and that the balance sheet should reflect the financial position of the entity not the risks at which it is exposed to.

According to the performance obligation approach the lessor continues to recognise the whole asset but also a lease receivable which implies a double accounting of the same asset (right to future benefits). The concentration on the physical asset is not consistent with the view according to which assets are a bundle of rights.

The use of two accounting models (the performance obligation approach and the partial derecognition approach) for lessors maintains the same complexities and problems from IAS 17 without a clear improving of financial reporting.

Question 3: Short-term leases

The exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is twelve months or less:

(a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and

subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognise lease payments in profit or loss over the lease term (paragraph 64).

(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognise assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognise any portion of the underlying asset. Such lessors would continue to recognise the underlying asset in accordance with other IFRSs and would recognise lease payments in profit or loss over the lease term (paragraph 65).

(See also paragraphs BC41–BC46.)

Do you agree that a lessee or a lessor should account for short-term leases in this way?

Why or why not? If not, what alternative approach would you propose and why?

The ED allows to the lessor and to the lessee to apply the simplified requirements on a lease-by-lease basis. This rule based approach (because there is no economic difference between less than one year and other leases) may impair the comparability and permit lessees and lessors to choose based on the desired accounting treatment. If this simplified accounting treatment is maintained based on practical grounds it should be applied consistently for all leases.

Definition of a lease

The exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1–B4 and BC29–BC32). The exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59–BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29–BC32).

Question 4

- (a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why? (b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?
- (c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

If the assets are seen as a bundle of rights the tangible –intangible distinction can not provide a robust base for the accounting treatment of different contracts granting rights. Under these circumstances the boundary between leases and service contracts will be difficult to determine concentrating on the tangible asset. IASB considers purchases/sales those arrangements that transfer the control of the underlying asset and all but a trivial amount of the risks and benefits associated with the underlying

assets. This view, mixing the control approach with the risks and awards approach, is not fully consistent with Revenue Recognition ED which might create problems in representing certain sale transactions which are not sales based on ED Leasing.

Scope

Question 5: Scope exclusions

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS to all leases, including leases of right-of-use assets in a sublease, except leases of intangible assets, leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33–BC46).

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

Excluding intangible assets from the proposal could lead to a different accounting treatment for contracts having similar economic substance. If they are discussed separately within the Revenue Recognition ED is important to ensure a coherent solution in both projects. This ED involves the revision of IAS 40 regarding situations when property held under a lease is an investment property.

Question 6: Contracts that contain service components and lease components The exposure draft proposes that lessees and lessors should apply the proposals in *Revenue from Contracts with Customers* to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5–B8 and BC47–BC54). If the service component in a contract that contains service components and lease components is not distinct:

- (a) the FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.
- (b) the IASB proposes that:
- (i) a lessee should apply the lease accounting requirements to the combined contract.
- (ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
- (iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the proposals in *Revenue from Contracts with Customers*.

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

We consider that the ideal situation should be as leasee and lessor to account for the services and lease components of a contract separately. When services are considered non distinct we agree the proposal contained in the ED, that the lessee should apply

the lease accounting requirements to a contract that contains non distinct service components and lease components.

The lessor should always be required to account for the services and lease components of a contract separately. The use of two accounting models for lessors generates inconsistency in the accounting treatment used in even if the economic reality is similar.

Question 7: Purchase options

The exposure draft proposes that a lease contract should be considered as terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64). Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

We don't agree with the proposal that options to purchase should be ignored until they are exercised. Ideally the options should be recognised and measured at fair value separately. Having the complexity of determining fair value they could be recognised and measured at the intrinsic value.

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

We agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur.

Measurement

The exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that:

- (a) assumes the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 13, 34, 51, B16–B20 and BC114–BC120).
- (b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121–BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be measured reliably.
- (c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and

residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132–BC135).

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why? Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?

Residual value guarantees should be recognised as assets and liabilities. Related to measurement we consider that a consistent approach should be used for all variable lease payments. The use of an expected outcome technique is complex and more difficult to be interpreted by users. A most probable outcome approach could be used accompanied by a periodic reassessment of assets and liabilities.

Ouestion 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

We agree with the IASB's approach.

Sale and leaseback

The exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents the sale of the underlying asset, the leaseback would also meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66–67, B31 and BC160–BC167).

Ouestion 11

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

We agree with the IASB's approach to sale and leaseback transactions.

Presentation

The exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25–27, 42–45, 60–63 and BC142–BC159).

Question 12: Statement of financial position

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143–BC145)?

Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

- (b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Lessees

Property, plant and equipment are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period.

An *intangible asset* is an identifiable non-monetary asset without physical substance.

The definitions of Property, plant and equipment and intangible assets are not operational in explaining the inclusion of the right to use assets in one category or another.

We consider that owned assets and assets held under a lease and lease liabilities and other borrowings should be presented separately.

Lessors

If lessors apply the derecognition approach a separate and different presentation in the statement of comprehensive income and statement of financial position should be done based on the business model. The presentation requirements in the performance obligation approach reflect the problems raised by this approach. Paragraph BC148 of the ED explains that the linked presentation is required because of the interdependency of the assets and liabilities originated by the lease transaction and because it alleviates the concern that under the approach both assets and liabilities are overstated in the statement of financial position.

If IASB is considering to maintain the performance approach a net presentation of the asset and the relate obligation could diminish the negative impact on the financial position (although we don't consider that disclosure can alleviate recognition and measurement problems).

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

We agree with the separate presentation in the income statement. Some presentation difficulties are raised by the performance approach (by the double accounting of the asset and the receivable) when both the receivable and the asset are impaired.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

We agree to the separate presentation within cash flow statement. In order to ensure consistency the interest should be presented in the same activity type with other interest cash flows (according to the presentation option used by the entity in compliance with IAS 7).

Disclosure

Question 15

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

(a) identifies and explains the amounts recognised in the financial statements arising from leases; and (b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows (paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

We consider that the proposed disclosure requirement are necessary in order to ensure transparency.

Transition Question 16

- (a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186– BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

We understand the practical reasons for advancing a simplified transition approach for long term leases. An option may be given to entities to apply a retrospective treatment in compliance with IAS 8.

Benefits and costs

Ouestion 17

Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

As any other change in accounting policies costs are expected to incur on changing the informational and control systems or in educating the staff. The impact is more significant if IFRS are applied directly at the individual financial statements level and financial statements are used as informational source for tax or capital requirements purposes. Difficulties may arise for entities in the process of first time application of IFRS for which any change to the current IFRS signify additional costs.

The cost benefit analysis should analyse if the current proposal is a real improvement to the actual situation.

Other comments Question 18

Do you have any other comments on the proposals?

Parragraph 41 states that under the performance approach a lessor shall apply IAS 39 at each reporting date to determine whether the right to receive lease payments is impaired and shall recognise any impairment loss in profit or loss.

We consider that the valuation of the impairment loss for the receivable and the asset under the performance approach should be clarified.

Sincerely yours